Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 95-134

In the Matter of

Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes

CC Docket No. 92-133

REPORT AND ORDER

Adopted: March 30, 1995 **Released: April 6, 1995**

By the Commission:

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I. Introduction

1. Part 65 of our rules[1] sets forth procedures and methodologies for prescribing and enforcing the rate of return certain local exchange carriers ("LECs") may earn on interstate access service.[2] The Commission adopted those rules in 1985. In the Notice in this proceeding,[3] we proposed a fundamental reform of those rules in order to reflect the dramatic changes in the telecommunications industry and our regulation of it that had occurred since that time. This Report and Order accomplishes that reform by streamlining our rate of return represcription and enforcement processes in ways that, we believe, will substantially reduce the burden of our regulations on the public and on those LECs still subject to rate of return regulation. The changes achieve a proper balance of regulatory goals by allowing a carrier the opportunity to "maintain its credit and to attract capital"[4] and by ensuring that ratepayers are charged reasonable rates for interstate services.

[1] 47 C.F.R. Part 65.

[2] Access service includes services and facilities provided for the origination or termination of interstate telecommunications services. 47 C.F.R. §69.2(b). It includes any activity or function that a LEC performs to connect interexchange carriers with their subscribers or end users. LECs are compensated for providing different access services through subscriber line and other access charges. See 47 C.F.R. Part 69.

[3] Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes, Notice of Proposed Rulemaking and Order, 7 FCC Rcd 4688 (1992) (Notice).

[4] FPC v. Hope Natural Gas, 320 U.S. 591, 603 (1944).

2. When Part 65 was adopted, the Commission used rate of return principles to regulate the rates for the interstate communications services of the American Telephone and Telegraph Company ("AT&T") and all LECs. Since that time, our price cap initiatives have removed all interexchange and most interstate access revenues from such regulation.[5] We have also created optional programs that allow the remaining rate of return LECs to increase their opportunities for increased profit and risks of loss above the levels they would face under traditional, rate of return regulation.[6]

3. To reflect the altered environment as well as our experiences in implementing the Part 65 rules, we change virtually every aspect of our rate of return represcription and enforcement processes for telephone companies. First, we amend the current rule that contemplates a new represcription proceeding every two years regardless of conditions in the capital markets. We replace that rule with one that relies on the yields on ten-year United States Treasury securities to determine when represcription might be warranted. Under this system, we will issue a notice asking whether we should institute a represcription proceeding only if, for six consecutive months, the six-month average of those yields deviates by 150 basis points or more[7] from the yield on these securities measured as of our most recent represcription. After evaluating the responses to such a notice, we will decide whether a represcription proceeding is necessary and will then issue an order that either sets forth a procedural schedule for the proceeding or announces that a represcription proceeding is not necessary.

4. The current rules also establish a "paper hearing" process for represcription proceedings that is modelled after the system used in evidentiary hearings. Because this process contains procedural steps beyond those necessary for a full and complete record, we are adopting streamlined procedures that will reduce the inordinate delays and costs

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[5] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (LEC Price Cap Order), modified on recon., 6 FCC Rcd 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd 7482 (1991), further modified on recon., 6 FCC Rcd 4524 (1991) (ONA/Part 69 Order), petition for recon. of ONA/Part 69 Order pending, LEC Price Cap Order aff'd sub nom. National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993); Policy and Rules Concerning Rates for Dominant Carriers, Report and Order, and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) (AT&T Price Cap Order), recon., 6 FCC Rcd 665 (1991) (AT&T Price Cap Recon. Order), remanded on other grounds sub nom. AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992). We have recently completed a performance review of the AT&T price cap plan. Price Cap Performance Review for AT&T, CC Docket No. 92-134, Report, 8 FCC Rcd 6968 (1993). The Commission has proposed relatively minor adjustments to the AT&T price cap plan based on the performance review. Revision to Price Caps Rules for AT&T, CC Docket No. 93-197, Notice of Proposed Rulemaking, 8 FCC Rcd 5205 (1993). Our performance review of the LEC price cap plan is in progress. Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Notice of Proposed Rulemaking, 9 FCC Rcd 1687 (1994).

[6] Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Report and Order, CC Docket No. 92-135, 8 FCC Rcd 4545 (1993) (Regulatory Reform Order), petitions for recon. pending.

[7] Analysts describe changes in yields in terms of basis points. One basis point equals 0.01 percent.

experienced in previous represcription proceedings, yet provide parties full opportunity to present and evaluate relevant evidence.

5. Part 65 now uses a weighted average cost of capital to calculate a unitary, overall rate of return for rate of return LECs.[8] This calculation requires us to determine a cost of equity, cost of debt, and capital structure for LEC interstate access service.[9] To help us determine these components, Part 65 requires the Regional Bell Holding Companies ("RHCs") to undertake complex studies and submit the resulting data for inclusion in the record in represcription proceedings. Because we find the cost of equity studies unnecessary and the cost of debt and capital structure studies unduly complex, we eliminate the rules that require them. To facilitate the represcription process, however, we specify methods to calculate cost of debt and capital structure that rely on readily available data regarding the largest LECs for presumptive use in future represcription proceedings. Under this approach, we will use the specified methodologies in future represcription proceedings unless the record in those proceedings shows that the methodologies would produce unreasonable results.

6. Part 65 had authorized an automatic refund, with interest, of earnings exceeding what the rules refer to as "the maximum allowable rate of return."[10] In the Automatic Refund Decision,[11] the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") remanded this rule to the Commission. Because we find that our tariff review and complaint processes are sufficient to enforce the prescribed interstate rate of return, we eliminate that rule.

II. Background

A. Traditional Rate of Return Regulation

7. The rate of return represcription serves as an essential component of the form of rate of return regulation the Commission has traditionally applied to most telephone companies. Under this form of regulation, telephone companies computed their revenue requirements using the following formula:

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[8] We describe this rate of return as "unitary" because it applies to all rate of return LECs that do not obtain individualized rates of return. We describe it as "overall" to contrast our system with those that combine a prescribed unitary return on equity with company-specific costs of debt and capital structures to produce overall authorized rates of return that would vary among companies. See also infra Section III.

[9] In infra Section V, we explain this calculation in greater detail.

[10] 47 C.F.R. §65.700.

[11] AT&T v. FCC, 836 F.2d 1386 (D.C. Cir. 1988) (per curiam) (Automatic Refund Decision).

Revenue Requirements = ((Rate Base) x (Rate of Return)) + Expenses[12]

The rate for any given service equaled its revenue requirement divided by the demand anticipated for that service.

8. The Commission first prescribed an interstate rate of return in 1967, as part of a comprehensive investigation into the reasonableness of AT&T's interstate rates.[13] Between 1967 and 1984, the Commission represcribed that rate of return four times. Each of these prescription proceedings included traditional evidentiary hearings before an Administrative Law Judge.[14] They resulted in prescribed rates of return that AT&T used in calculating its long distance rates as well as the compensation the Bell Operating Companies ("BOCs") and independent telephone companies received for use of their facilities in originating and terminating interstate calls.

9. With the divestiture of AT&T in 1984,[15] however, the Commission decided to regulate directly the rates LECs charge for originating and terminating interstate calls.[16] In Docket 84-800, the Commission sought to develop procedures and methodologies to address the increased complexity of rate of return regulation in the post-divestiture environment.[17] The resulting Part 65 rules were designed to enable the Commission to represcribe authorized rates of return for LEC interstate access service and AT&T's interstate communications

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[12] This formula expresses the fact that a utility must receive an opportunity to earn revenues sufficient to recover its operating expenses, including taxes and depreciation, and a fair return on prudent investment that results in used and useful plant.

[13] American Tel. & Tel. Co., CC Docket No. 16258, Interim Decision and Order, 9 FCC 2d 30 (1967).

[14] American Telephone and Telegraph Co., Modification of Prescribed Rate of Return, 86 FCC 2d 221 (1981), aff'd sub nom. United States v. FCC, 709 F.2d 610 (D.C. Cir. 1983); AT&T (Docket 20376), 57 FCC 2d 960 (1976); AT&T (Docket 19129), 38 FCC 2d 213 (1972), aff'd sub nom. Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975); AT&T (Dockets 16258 and 15011), 9 FCC 2d 30 (1967).

[15] United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

[16] See MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983), modified on further recon., 97 FCC 2d 682 (1983), modified on second further recon., 97 FCC 2d 834 (1984), aff'd in pertinent part sub nom. National Ass'n of Regulatory Util. Comm'rs v. FCC, 737 F. 2d 1095 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985), modified on further recon., 99 FCC 2d 708 (1984), aff'd sub nom. American Tel. and Tel. Co. v. FCC, 832 F. 2d 1285 (D.C. Cir 1987), modified on further recon., 101 FCC 2d 1222 (1985), recon. denied, 102 FCC 2d 849 (1985).

[17] Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800, Notice of Proposed Rulemaking, FCC 84-395, 49 Fed. Reg. 32971 (August 17, 1984); Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800, Supplemental Notice of Proposed Rulemaking, FCC 85-458, 50 Fed. Reg. 33786 (August 21, 1985).

services without engaging in traditional evidentiary hearings.[18]

10. The Part 65 rules establish a "paper hearing" for represcribing authorized interstate rates of return. The process includes notices of appearance, initial submissions, responsive submissions, rebuttals, limited discovery, Common Carrier Bureau ("Bureau") information requests, proposed findings of fact and conclusions, and reply findings of fact and conclusions. Under limited circumstances, the rules permit cross examination, oral argument, and use of separated trial staff. The rules require exchange carrier holding companies meeting certain specified criteria to file notices of appearance, to undertake complex studies using particular methodologies, to include the data resulting from these studies in their initial submissions, to respond to Bureau information requests, and to comply with any discovery orders.[19] The only holding companies that have met these criteria are the RHCs.

11. In 1986, the Commission used the Part 65 rules to represcribe the LECs' rate of return for their interstate access services. That experience, while largely successful, revealed some flaws in the rules. In CC Docket No. 87-463, the Commission proposed to refine Part 65 to eliminate those flaws.[20] Although it recognized that the represcription process might require more fundamental reform in light of the pending price cap initiative, the Commission invited comment only on those revisions that might aid in the next represcription proceeding.[21]

12. That next proceeding occurred in 1990.[22] In initiating it, the Commission rejected suggestions that it wait until it had completed Docket 87-463. Instead, we used the existing Part 65 rules, but waived them to the extent necessary to correct for flaws revealed during the 1986 represcription proceeding and to recognize other post-divestiture

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[18] Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, Report and Order, CC Docket No. 84-800, Phase II, 51 Fed. Reg. 1795, at paras. 3, 70-72 (Jan. 15, 1986) (Phase II Order), recon. 104 FCC 2d 1404 (1986) (Phase II Reconsideration).

[19] See, e.g., 47 C.F.R. §§65.100(a)(1), 65.102(a), 65.103(a), 65.200.

[20] Refinement of Procedures and Methodologies for Represcribing Interstate Rates of Return for AT&T Communications and Local Exchange Carriers, CC Docket No. 87-463, Notice of Proposed Rulemaking, 2 FCC Rcd 6491 (1987), terminated, 7 FCC Rcd 5949 (1992).

[21] Id. at 6491.

[22] Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Order, 5 FCC Rcd 7507 (1990) (1990 Represcription Order), recon. denied, 6 FCC Rcd 7193 (1991) (1990 Represcription Reconsideration Order), aff'd sub nom. Illinois Bell Telephone Co. v. FCC, 988 F.2d 1254 (D.C. Cir. 1992) (Illinois Bell v. FCC).

developments.[23] In Illinois Bell v. FCC, the D.C. Circuit affirmed this procedure and recognized that Part 65 allows the Commission to consider a broad array of evidence and methodologies in the represcribing rate of return, including "rate calculation methodologies other than those explicitly spelled out in Part 65."[24]

B. Incentive Regulation

13. Traditional, rate of return regulation affords the regulated company the opportunity to recover through its rates all of its prudently incurred costs that prove used and useful in the provision of regulated service. Because this form of regulation gives the regulated company only minimal incentives to operate efficiently, we have developed alternative forms of regulation that attempt to create efficiency incentives similar to those found in fully competitive markets. Our AT&T and LEC price cap plans reward innovation and increased productivity by regulating prices directly, rather than indirectly through the examination of projected costs and demand as under traditional rate of return regulation. These plans took effect July 1, 1989 and January 1, 1991, respectively.[25] Both plans require telephone companies to adjust their price cap indexes to reflect inflation,[26] certain productivity offsets,[27] and exogenous costs.[28] The LEC price cap plan also requires LECs whose earnings exceed certain levels to share those additional earnings with customers

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23 Refinement of Procedures and Methodologies for Represcribing Interstate Rates of Return for AT&T Communications and Local Exchange Carriers, CC Docket No. 87-463, Order, 5 FCC Rcd 197, 202-03 (1989) (Interim Prescription Order), recon. denied 7 FCC Rcd 5949 (1992).

24 Illinois Bell v. FCC, 988 F.2d at 1265-66.

25 LEC Price Cap Order, 5 FCC Rcd at 6837; AT&T Price Cap Order, 4 FCC Rcd at 2968.

26 The inflation adjustments reflect changes in the Gross National Product Price Index (GNP-PI) as reported by the United States Department of Commerce. 47 C.F.R. §61.3(p). This is a broad-based index computed by the Federal government that reflects changes in the cost factors of production for a wide spectrum of economic sectors. It is also known as the fixed-weight GNP deflator.

27 The productivity offset for AT&T is 3.0 percent. AT&T Price Cap Order, 4 FCC Rcd at 2989, 3001. LECs may elect productivity offsets of either 3.3 percent or 4.3 percent. LEC Price Cap Order, 5 FCC Rcd at 6796, 6801.

28 Under price caps, most increases and decreases in a carrier's cost of providing regulated service are treated as "endogenous" changes, and do not result in adjustments to the carrier's price cap indexes. The Commission, however, has identified certain types of cost changes, triggered by administrative, legislative, or judicial action that are beyond the carrier's control, that should result in adjustments to those indexes. LEC Price Cap Order, 5 FCC Rcd at 6807; AT&T Price Cap Order, 4 FCC Rcd at 3187. The Commission concluded that failing to recognize these cost changes through price cap index adjustments would unjustly punish or reward the carrier. LEC Price Cap Order, 5 FCC Rcd at 6807. Accordingly, the Commission found that those types of cost changes should be treated "exogenously" in order to ensure that price cap regulation did not lead to unreasonably high or unreasonably low rates.

through prospective rate reductions.[29]

14. We have more recently adopted an optional incentive plan that gives non-price cap LECs, who are willing to assume more risk, the opportunity to realize increased profits while remaining under rate of return regulation.[30] This plan permits non-price cap LECs to retain earnings up to 1.5 percent above the rate of return prescribed for LEC interstate access service. In exchange, LECs electing this form of regulation must file tariffs that remain in effect for two-year periods. The LECs must target these rates to earn the prescribed interstate rate of return. During that two-year period, these LECs may increase their tariffed rates only if necessary to produce earnings 0.75 percent below the prescribed interstate rate of return.[31]

III. Unitary Rate of Return

A. Background

15. In the Notice, we identified a number of reasons to justify significantly revising the rate of return prescription procedures and methodologies set forth in Part 65. Most importantly, we recognized that we had promulgated those rules at a time when we regulated virtually all the interstate services of the post-divestiture AT&T and the BOCs, as well as the other LECs, on a rate of return basis.[32] We stated that since that time, technological change had made possible an explosion of regulated and nonregulated services offered by carriers. We also recognized that, in response to these developments, we had introduced price cap regulation for the interstate services of AT&T and the largest LECs, including the BOCs.[33] We noted that the carriers who remained subject to rate of return regulation then accounted for only about 6.3 percent of total LEC revenue.[34] We stated our belief that these changes

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[29] LEC Price Cap Order, 5 FCC Rcd at 6801-02, paras. 123-27. More specifically, price cap LECs may increase their interstate rates to the extent necessary to earn a 10.25 percent interstate rate of return. LECs electing the 3.3 percent productivity offset may retain all interstate earnings up to 12.25 percent, 50 percent of interstate earnings between 12.25 percent and 16.25 percent, and no interstate earnings above 16.25 percent. LECs electing the 4.3 percent productivity offset may retain all interstate earnings up to 13.25 percent, 50 percent of interstate earnings between 13.25 percent and 17.25 percent, and no interstate earnings above 17.25 percent. Id.

[30] Regulatory Reform Order, 8 FCC Rcd at 4547.

[31] Id. at 4550.

[32] Notice, 7 FCC Rcd at 4690, para. 13.

[33] Id. at para. 14.

[34] Id.

required us to fundamentally re-examine our rate of return represcription processes.[35] We tentatively concluded that simplified procedures and methodologies could replace the cumbersome and expensive process that we and the telephone industry had confronted in the 1990 represcription proceeding.[36] We requested comment on a detailed set of procedural and methodological issues. We also proposed to retain our current policy of prescribing a unitary, overall rate of return for rate of return LECs.[37] Under this policy, we prescribe a single rate of return, rather than rates of return for individual LECs. This is, moreover, an overall rate of return, rather than a return on equity. Each rate of return LEC must use this prescribed rate of return in computing its interstate revenue requirements, unless the LEC shows that such use would be confiscatory.

16. We address the procedural and methodological issues raised in the Notice, as well as the parties' comments, infra.[38] In this Part, we confirm that we will retain a unitary, overall rate of return for rate of return LECs.[39]

B. Comments

17. For a variety of reasons, commenters overwhelmingly support reforming our represcription procedures and methodologies, but retaining a unitary rate of return for rate of return LECs.[40] OPASTCO, for example, contends that a unitary rate of return benefits small companies, NECA, and this Commission by helping to simplify represcription proceedings and by facilitating the administration of the universal service fund and the long-term support program.[41] Some commenters conclude that a unitary rate of return best balances the competing goals of administrative ease and fairness. These commenters state that developing

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[35] Id. at para. 15.

[36] Id. at para. 16.

[37] Id. at para. 18.

[38] Appendix I lists the commenters as well as the short names this Order uses to refer to them.

[39] In infra Section IV.B.4, we address the standard for obtaining an individualized rate of return.

[40] See, e.g., Bell Atlantic Comments at 2; Casco Comments at 1; Frederick & Warinner Comments at 2; SNET Comments at 2; USTA Comments at 4.

[41] OPASTCO Comments at 2. See also Alltel Comments at 2. The universal service fund and long term support program share a common purpose of promoting affordable telephone service throughout the nation. The universal service fund helps carriers operating in high cost areas maintain low intrastate service rates in those areas. See 47 C.F.R. §§69.116, 69.603(c). The long term support program requires LECs that do not participate in the common line pool administered by the National Exchange Carrier Association, Inc. (NECA) to contribute part of their revenue to that pool. The contributions let NECA maintain a nationwide average common line rate equivalent to the rate that would result if all LECs participated in the common line pool. See 47 C.F.R. §§69.2(y), 69.612.

a rate of return for each of the approximately 1300 to 1400 LECs remaining under rate of return regulation would be unnecessarily costly.[42]

C. Discussion

18. Although we reform our represcription procedures and methodologies, as set forth below, we retain our current policy and will continue to prescribe, a unitary, overall rate of return for rate of return LECs. We agree with the commenters that a unitary rate of return best balances our twin policies of promoting administrative simplicity and efficiency and developing a fair rate of return for all affected carriers. Nothing in the record suggests that an appropriately developed unitary rate of return would not operate fairly for all rate of return LECs and their customers. Moreover, the administrative burdens associated with developing separate rates of return for over 1300 affected LECs would be significant, and would impose unnecessary costs on this Commission and on telephone companies and their ratepayers.

19. In retaining our policy of prescribing a unitary, overall rate of return, we recognize that some telephone companies may face exceptional facts and circumstances that warrant rates of return different from the prescribed interstate rate of return. We will not preclude requests for such individualized rate of return. In Section IV.B.4, infra, we address the standard for obtaining them.

IV. Revisions to Represcription Procedures

A. Initiating Represcription Proceedings

1. Background

20. Our Part 65 rules require biennial represcription proceedings that are supposed to begin during January of each even-numbered year.[43] Notwithstanding this provision, the Commission has deferred each required represcription since those rules were adopted. The Notice stated our belief that a calendar-based, biennial requirement does not reflect how the cost of capital for LEC interstate access service changes over time. We also stated that we could use generally available capital market data to predict those persisting changes to the cost of capital that might justify a represcription and that the periodic review of such data would allow us to initiate represcription proceedings only when they are warranted.[44] Consequently, in the Notice, we proposed to replace the automatic, biennial trigger with a

[42] See, e.g., SNET Comments at 2; USTA Comments at 4.

[43] 47 C.F.R. §65.102(c).

[44] Notice, 7 FCC Rcd at 4691, at paras. 19, 21.

trigger activated by identified changes in capital markets that are likely to persist over time.[45] We invited comment on whether we should adopt such a trigger, and whether the trigger should be automatic or semi-automatic.[46] We also invited comment on how we should measure persistent changes in capital markets;[47] whether we should base the trigger on a single measure of capital costs, and how we might track changes in that measure over time by using a "moving average;"[48] and whether we should specify some minimal period between represcriptions so as to ensure that Commission represcription decisions do not result in unduly frequent changes in interstate rates.[49]

2. Comments

21. The commenters generally support our proposal to replace the existing calendar-based trigger with a trigger activated by identified changes in capital costs.[50] Frederick and Warinner states that the current biennial trigger does not recognize relevant cost of capital developments either in the telecommunications industry or in the financial community, and imposes unwarranted administrative and economic burdens.[51] Bell Atlantic explains that, unlike a calendar-based trigger, a trigger based on capital market developments would reflect how rate of return LECs raise capital, would minimize regulatory costs by avoiding unnecessary represcription proceedings, and would streamline regulation generally.[52]

22. Notwithstanding this general agreement, the commenters disagree about what the trigger should be, about how it should operate, and about all the other issues the Notice raised regarding the trigger. Large LECs, small LECs, and their representatives generally concur on what a trigger driven by changes to capital costs should be and how it should work. These commenters argue that the Commission should base the trigger on long-term debt costs, rather than the cost of equity, because debt costs are directly observable, whereas

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[45] Id. at paras. 19, 21, 25.

[46] Id. at paras. 21, 25. If activated, an automatic trigger would initiate a represcription proceeding without further Commission action. Under a semi-automatic trigger, the triggering event would prompt a Commission inquiry asking whether a represcription proceeding should ensue. Id. at para. 25.

[47] Id. at para. 22.

[48] Id. at para. 23.

[49] Id. at para. 24.

[50] See, e.g., USTA Comments at 32; SWBT Comments at 1-2; OPASTCO Comments at 3; MCI Comments at 4-5; GSA Comments at 6.

[51] Frederick and Warinner Comments at 5.

[52] Bell Atlantic Comments at 4.

measuring equity costs is more controversial.[53] USTA argues for the use of Aa public utility bond yields listed in Moody's Bond Record.[54] According to USTA, such bonds most accurately reflect the capital costs rate of return LECs incur.[55] To ensure that the trigger reflects only significant and persistent changes in capital costs, USTA recommends that a range of 300 basis points, 150 above the midpoint and 150 below the midpoint, be set to mark the boundary between significant and insignificant cost changes.[56] USTA would have the Commission consider initiating a represcription proceeding only if there is a 150 basis point shift in the six-month moving average of Aa public utility bond yields as measured by Moody's, and then only if such a shift continues for six consecutive months.[57] According to USTA, these requirements would help ensure that the trigger only recognizes persistent changes in the capital markets. USTA states that the counting of the six consecutive months should begin with the order completing this rulemaking. At that time, the Commission also should set the initial yield rate that is to be compared with the six-month moving average, according to USTA.[58]

23. USTA describes this proposed trigger as semi-automatic. USTA argues that an automatic trigger would give no discretion to the Commission in determining whether to initiate a represcription proceeding, but would operate objectively and so insulate the Commission from external pressures.[59] USTA doubts, however, that the Commission can devise a truly automatic trigger because the Commission could always interpose its waiver power to prevent the trigger's operation.[60] USTA argues that a semi-automatic trigger would be preferable, because it would afford the Commission more flexibility and could avoid unnecessary represcription proceedings.[61] USTA maintains that, if the Commission nevertheless opts for an automatic trigger, the range should be plus or minus 200 basis points

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[53] E.g., USTA Comments at 34. See also Rochester Comments at 15-16; SNET Comments at 3.

[54] USTA Comments at 33-34. See also Rochester Comments at 15-16; SNET Comments at 3. Moody's Bond Record contains monthly prices, yields, and ratings for individual bond issues, convertibles, and preferred stocks.

[55] USTA Comments at 33-34.

[56] Id. at 34-36.

[57] Id. at 33-34. See also Rochester Comments at 15-16; SNET Comments at 3.

[58] USTA Comments at 36.

[59] Id. at 37.

[60] Id.

[61] Id. at 38. See also OPASTCO Comments at 3-4; SNET Comments at 3.

to promote greater stability and avoid repetitive proceedings.[62] Regardless of the trigger adopted, USTA states that a carrier should be able to seek an individual represcription.[63] Most LEC commenters support USTA.[64]

24. Centel advocates a USTA-type trigger based on a sustained plus or minus 150 basis point deviation from the base rate of Aa utility bonds. Centel also would require that there be at least a 150 basis point deviation in the most recent month from the base rate to "avoid unnecessary represcriptions when changes in the credit markets reverse or correct themselves" in the short term.[65] Additionally, if the triggering event occurs, Centel urges the Commission to consider other factors, including forward-looking evaluations of the cost of equity, in determining whether a represcription proceeding is warranted.[66]

25. GSA proposes a different trigger, one based on changes in the monthly indicator for intermediate term United States Treasury bond interest rates. Instead of using industry bond yields, GSA would have us measure changes in capital costs by monitoring changes to the ten-year United States Treasury security yield indicator prepared monthly by the Council of Economic Advisors.[67] According to GSA, this indicator would reflect fundamental changes in equity costs better than would short or long-term bond yields, and its use would avoid the need to compile and analyze complex stock market data, because the government publishes the indicator monthly.[68]

26. Like USTA, GSA proposes a trigger that includes a range of plus or minus 150 basis points around a midpoint.[69] GSA, however, would have the Commission review changes in the ten-year treasury bond yield indicator in September of each year, and automatically initiate a represcription proceeding if the indicator for the previous month (August) deviated more than 150 basis points from the indicator at the time of the

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[62] USTA Comments at 39. Cf. Rochester Comments at 15-17 (supporting an automatic trigger otherwise composed like USTA's).

[63] USTA Comments at 39. See infra Section B.4. for a discussion of individualized represcription proceedings.

[64] See, e.g., Alltel Comments at 2; Cincinnati Bell Comments at 1-2; Nebraska Comments at 3; Van Horne Comments at 2.

[65] Centel Comments at 3-4.

[66] Id. at 4-6.

[67] GSA Comments at 8-9.

[68] Id.

[69] Id. at 10.

Commission's most recent represcription.[70] According to GSA, the Commission could conclude a represcription proceeding initiated in September in time for the carriers to incorporate the results into their annual access tariff filings in April of the following year. GSA states that if a represcription proceeding were concluded in March, the new midpoint of the range would be the ten-year Treasury Bond yield indicator for the previous month.[71] GSA prefers an automatic trigger for the reasons USTA identifies in its comments; GSA agrees that an automatic trigger would eliminate controversy over when represcription proceedings should start and would operate objectively over time.[72] GSA also says that an automatic trigger would insulate the Commission and carriers from external pressures better than a semi-automatic trigger would.[73]

27. MCI suggests a third model for a capital cost change-driven trigger. MCI proposes a semi-automatic trigger based on changes in a combination of both cost of debt and cost of equity measurements. MCI states that the trigger could rely on long-term interest rates and the average of the discounted cash flow ("DCF") estimates of the RHCs' costs of equity.[74] MCI states that the trigger should require significant changes in these measures, such as a 200 basis point change in debt costs and a 100 basis point change in equity costs, that are simultaneous and last for six months.[75]

28. MCI argues that we should revise Part 65 to provide that the triggering event creates a presumption that represcription should ensue, a presumption that commenters could rebut by showing that the trigger did not accurately identify changes in the cost of capital for LEC interstate access services.[76] MCI would also have the rules state that the need for a change in the prescribed rate of return would be addressed de novo, in any ensuing represcription proceeding.[77] To ensure stability, MCI would require at least one-year between represcription proceedings. MCI would also require a Commission review every six months to determine whether the triggering events had occurred.[78] MCI states that the first

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[70] Id.

[71] Id.

[72] GSA Reply at 6. See also, supra para. 23.

[73] Id.

[74] MCI Comments at 4-6. The DCF method estimates the present value of future cash flows. In infra Part V.C.3, we describe this method in greater detail.

[75] Id. at 5-6.

[76] Id. at 6.

[77] Id. at 7.

[78] Id. at 7.

review following any represcription order would be conducted on its one-year anniversary. At that time, the Commission would check on possible changes in the trigger measures during the most recent six months, according to MCI. Notwithstanding its stability concerns, MCI contends that the Commission should allow petitions for represcription independent of the trigger, although in such cases MCI would have the petitioner bear the burden of showing that a proceeding is warranted.[79] In MCI's view, any order authorizing such a proceeding should not establish a presumption in the ensuing proceeding.[80]

29. FWA and SBA propose still other approaches. FWA states that DCF cost of equity estimates for the Standard and Poor's ("S&P") 400, the RHCs, the 100 large electric utilities or other comparable publicly traded companies might provide appropriate benchmarks to judge the need for represcription.[81] FWA says that tracking a moving average for a single measure of capital costs over time would be a viable basis for determining when a represcription proceeding is warranted. FWA maintains, however, that, in the ordinary course, at least three years ought to separate represcriptions in order to accommodate LEC budgeting for capital recovery, infrastructure development and necessary operational changes.[82]

30. SBA, on the other hand, argues for a semi-automatic trigger based on capital costs incurred by companies similar to the small LECs.[83] SBA states that general indices of capital market health are not representative of the capital costs of small LECs.[84] At any rate, says SBA, the Commission should rely on indices restricted to utilities.[85] An appropriate trigger must also, according to SBA, account for changes in the cost of private and governmental debt.[86]

3. Discussion

31. We conclude that the public interest is best served by adopting a semi-automatic trigger, based on ten-year U.S. Treasury security yields, that employs a 150 basis point change. Under our trigger, we will issue a notice asking whether a represcription should

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[79] Id. See infra Section B.4. for a discussion of individualized represcription proceedings.

[80] MCI Comments at 8-9.

[81] FWA Comments at 5.

[82] Id.

[83] SBA Comments at 7.

[84] Id.

[85] Id.

[86] Id.

ensue, whenever the triggering event occurs evidencing major changes in the capital markets. We delegate power to the Chief, Common Carrier Bureau, to issue such Notices.[87] The triggering event will be a 150 basis point change in the monthly average yield on ten-year U.S. Treasury securities that continues for a six-month period. To establish the starting point for measuring the change, we will compute an average of the monthly average yield on ten-year U.S. Treasury securities for the six months prior to the date of our most recent represcription. Each month, we shall monitor our trigger by comparing this six-month average and the current month's average yield on ten-year U.S. Treasury securities to determine if they differ by 150 basis points or more.

32. There is no dispute in the record about the merit of replacing the current biennial trigger with a trigger based on some measurement of persistent change to the cost of capital. All commenters favor the latter for the reason we cited in the Notice: LEC capital costs do not track the calendar.[88] The commenters disagree, however, about whether the trigger should be automatic or semi-automatic, and about what sort of measuring methodology we should adopt. While we understand GSA's arguments that an automatic trigger would operate "objectively" over time and avoid controversy, we do not believe that such "objective" operation is ipso facto beneficial or that any "automatic" trigger would not engender repeated deferral orders.[89] Represcription proceedings are costly and time-consuming for this Commission and for participants. We think that it would better serve the public interest if we were to evaluate the need for a represcription proceeding once the triggering event occurs.

33. On the question of what the trigger should measure, the commenters basically fall into three groups: (1) one who advocates a mix of debt and equity cost measurements;[90] (2) those who advocate a debt instrument trigger employing Treasury bonds;[91] and (3) those who advocate a debt instrument trigger employing Aa utility bonds.[92] Although the overall cost of capital reflects both debt and equity costs, we find no compelling reason to adopt a trigger based on multiple measures of capital costs. Such a trigger would be unnecessarily complicated for the limited purpose of determining whether we should inquire into whether

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[87] See Appendix 4, 47 C.F.R. 65.101(a).

[88] See e.g., Bell Atlantic Comments at 2; USTA Comments at 32.

[89] See, e.g., Refinement of Procedures and Methodologies for Represcribing Interstate Rates of Return for AT&T Communications and Local Exchange Carriers, CC Docket No. 87-463, Memorandum Opinion and Order, 3 FCC Rcd 1697 (1988) (deferring 1988 represcription proceedings for one year); Deferral of Rate of Return Represcription Filings Pursuant to Section 65.102(c), Memorandum Opinion and Order, 3 FCC Rcd 7220 (1988)(deferring 1988 represcription proceedings for an additional six-month period).

[90] MCI Comments at 5-6.

[91] See, e.g., GSA Comments at 8-9.

[92] See, e.g., USTA Comments at 33-34.

sufficient cost of capital changes have occurred to justify a represcription proceeding. A Commission decision to initiate a proceeding would depend on the record developed in that inquiry, which could incorporate multiple measures of both debt and equity costs.

34. As between using debt or equity cost measurements for the trigger, we agree with several commenters that methodologies for measuring changes in the cost of debt are far less controversial, and easier to apply, than cost of equity methodologies.[93] Most cost of debt methodologies rely on information available from publicly available sources, such as the financial sections of daily newspapers. In contrast, cost of equity methodologies require extensive analyses of data bases that we would have to purchase from vendors or obtain from telephone companies or their representatives. We find no advantages to offset the additional burdens of equity-based triggers such as those suggested by FWA that would use discounted cash flow (DCF) cost of equity estimates for the S&P 400, the RHCs, the 100 large electric utilities or other comparable publicly traded companies. For a similar reason, we find little benefit in using the trigger suggested by SBA based on the capital costs of small companies for which relevant data are not routinely made available to us. Any such trigger would require that we impose a filing burden on small companies at this time. We believe that the better course is to adopt a trigger based on available data while deferring questions regarding the small LECs' actual capital costs until the triggering event occurs.[94] We recognize, however, that a debt-based trigger may not always signal when rate of return represcription proceedings are necessary. For example, cases may emerge where equity returns are much more volatile than debt returns. In these cases, any interested person will be able to petition the Commission to examine whether a represcription proceeding is warranted.

35. The commenters suggest a variety of debt measurements that we could incorporate into our trigger. These debt measurements have many similarities, but there are important differences. Yields on Aa utility bonds and on intermediate and long-term U.S. Treasury securities are dependent on investor expectations regarding capital market movements, and both would allow us to track changes in capital costs. We choose to rely on U.S. Treasury yields, however, because they are easier to track than Aa bond yields. Moreover, as pointed out by GSA, rates on U.S. Treasury securities, unlike yields on Aa utility bonds, do not include a default risk factor and are unlikely to be influenced by financial and regulatory practices that are particular to other public utility industries, such as

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[93] See id. at 34. Debt costs are essentially the fixed interest payments that companies make to bondholders regardless of the level of company earnings. The various interest rates to which a company is subject are readily obtained from the debt instruments. The cost of debt can be directly observed in the market, because the promised amount and timing of the interest payments are fixed. See A. Lawrence Kolbe and James A. Read, Jr. with George Hall, The Cost of Capital 44 (1984). On the other hand, the cost of equity reflects investor expectations regarding future earnings on common stock. These earnings are residual in nature and available only after prior claims on earnings, including interest payments, are met. The methodologies used to estimate the cost of equity attempt to predict these residual earnings, which, of course, cannot be directly observed in advance. See Roger A. Morin, Regulatory Finance: Utilities' Cost of Capital 17, 27 (1994).

[94] See infra Section V.D.

the electric industry.[95] We agree with GSA that the yields on ten-year Treasury securities will tend to reflect fundamental changes in capital markets better than long term bond yields (maturities of 20 to 30 years).[96] Long-term bond yields are influenced too much by expectations of changes in the inflation rate over a prolonged period, and do not give proper weight to more immediate economic factors such as expansions and contractions in the economy.[97] Further, the longer the term of the security, the more uncertain the interest rate pattern. In these circumstances, we conclude that ten-year U. S. Treasury securities provide the proper time horizon for the trigger.

36. Most of the commenters suggest that an evaluation of the need for a represcription should be triggered by a change in yields of 150 basis points. In order to evaluate this suggestion, we ran tests using 100, 150, and 200 basis points to determine the number of times an evaluation would have been triggered during the fifteen-year period starting in 1980 under each of these measures. The tests used twelve different starting dates in 1980, 1981, and 1982 with each test period ending December 31, 1994.[98] We counted the number of times the trigger would have been activated during each test run based on changes in the monthly yields on ten-year U.S. securities of more than the specified amount of basis points for six consecutive months. We measured the change by comparing each month's average yield to the average of monthly yields for the six months preceding the start of the test. We established a new six-month period and calculated a new six-month average each time the trigger was activated during each run. We found that the starting point of the test period influenced how many times the trigger was activated during the test runs: the trigger was activated four to nine times using 100 basis points, four to six times using 150 basis points, and one to three times using 200 basis points. We believe that a measure of 200 basis points, which would have led to only one or two represcription proceedings during

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[95] GSA Reply Comments at 9. There are a number of ratemaking practices that are applied to electric companies, but not telephone companies, that influence the investment market. For example, increasingly, state commissions are requiring electric utilities to phase in the revenue requirement of newly completed plants that would significantly increase the existing rate base. Under these phase-in plans, electric utility rates to consumers are raised gradually over a period of years. These plans are unattractive to the investor, because they delay the cash flow and earnings-quality improvement that the utility would experience under more traditional ratemaking practices. Another problem unique to electric utilities that may affect investor confidence involves the considerable decrease in the rate of demand growth since 1973. Electrical utilities, in the midst of major capacity expansion, have found their existing plant to be adequate. In response, state commissions have imposed severe penalties, disallowing returns on investment in plant that is found to be excess capacity. Robert W. Burke, Utility Bond Analysis, in The Financial Analyst's Handbook 877-78 (Sumner N. Levine ed., 2d ed. 1988).

[96] GSA Comments at 8.

[97] Evelina M. Tainer, Using Economic Indicators To Improve Investment Analysis 7, 12 (1993); Frank J. Jones and Benjamin Wolkowitz, The Determinants of Interest Rates on Fixed-Income Securities, in The Financial Analyst's Handbook 301(Sumner N. Levine ed., 2d ed. 1988).

[98] The starting dates are: January 1, April 1, July 1, and October 1 for 1980, 1981, and 1982.

the fifteen-year period beginning in 1980, is not sensitive enough when one observes the significant fluctuations in yield rates during this period as shown in Chart 1 of Appendix 2 On the other hand, we believe that a measure of 100 basis points would be too erratic based on the wide range of triggering events (four to nine) that would have occurred during the fifteen-year period. Based on our test runs, we conclude that using 150 basis points as the trigger will enable us to begin the process of evaluating the need for represcriptions when circumstances would appear to warrant such an inquiry, but would not be so overly sensitive that minor fluctuations in market behavior would trigger represcription inquiries.

37. We will measure the change of 150 basis points from the average of the monthly average yield on ten-year U.S. Treasury securities for the six months prior to the date of the most recent represcription. This average will serve as the starting point for determining whether a represcription proceeding is warranted. We believe that the six-month average is necessary to minimize possible short-term distortions in the cost of capital and to reflect accurately the current level of ten-year Treasury yields at the time of a new represcription. For this reason, we reject GSA's recommendation that we base a represcription decision on an annual comparison of Treasury yields for the month of August.[99] We agree with NARUC that a bond yield for one month cannot give an accurate reading of the capital markets.[100] Moreover, comparing the rate for the same month year after year would not eliminate seasonal influences.[101]

38. The Notice proposed calculating a moving average of the indicator used to measure change in capital costs.[102] We have decided against using a moving average, because it apparently gives too much weight to past periods in a changing capital market and, thus, may be too slow to identify permanent cost of capital changes. Instead, we will use the monthly average yield amounts in the trigger, without computing a moving average. We recognize that some of these monthly average yields may be subject to the effects of random aberrations that distort them. We believe, however, that requiring the 150 basis point change in monthly average yields to persist for six consecutive months before the Commission acts will filter out the effect of any random aberration on our trigger mechanism.

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99 GSA Comments at 10.

100 NARUC Reply at 13.

101 USTA Reply at 3.

102 Notice, 7 FCC Rcd at 4691, at para. 23. A moving average is the average of a set number of the most recent values in a series of values. When a new value becomes available, the oldest value is no longer used to compute the average. Each value is given equal weight in computing the average, which means that the oldest value is given the same weight as the more recent values. This may lead to inaccuracies, if the moving average is used to predict the current state of the capital markets because the older values generally are less relevant to determining the current state of these markets.

39. Chart 1 of Appendix 2 depicts the monthly yields on ten-year U.S. Treasury securities from May 1981 to December 1994 and shows when the actual rate of return represcriptions were adopted during that period. Chart 2 depicts the same yield information, but shows when a reassessment of the rate of return would have occurred under our trigger mechanism. A comparison between the two charts indicates that our new trigger would have initiated reassessments at crucial points on the graph where permanent changes in the level of the yields occurred. The first would have occurred in March 1983, when the yields had dropped approximately 260 basis points from the previous prescription. Actually, the Commission did not represcribe a rate of return until August 1986, when the yield rates had dropped an additional 230 basis points. Our trigger would have responded to these major downward movements in yields more quickly.

40. Chart 2 also shows that our new trigger would have been activated in April 1989. The yields, however, decrease after that month, possibly indicating that a new represcription was not warranted. This represents an instance where the semi-automatic nature of our trigger might have come into play. The remaining section of the charts (1990 through 1994) show a significant downward trend and then a quick upswing in yields on ten-year U.S. Treasury securities. Again, these significant swings in yields would have activated our trigger mechanism.

41. Because we have designed the trigger to respond to only persistent changes in the cost of capital, we need not specify any minimum time between represcription proceedings. We will, however, consider the length of time since the last represcription in determining whether to initiate a represcription proceeding. This should prevent the kind of rate and service volatility that might result from frequent represcriptions. Based on the foregoing, we conclude that a 150 basis point change in monthly average yields on 10-year U.S. Treasury yields sustained over a six-month period will produce the best semi-automatic trigger and thus we adopt such a trigger.

42. As shown in Chart 1, the yields on ten-year U.S. Treasury securities for the most recent six months (September 1994 through February 1995) range from a low of 7.46% to high of 7.96%. All of these yields are within 150 basis points of 8.64%, which is the six-month average of yields at the time of our last represcription in September 1990.[103] We, therefore, find that the rate of return prescribed in September 1990 continues to be adequate to attract investment funds in the current capital markets but does not appear likely to yield unreasonably high profits, and we will not issue a notice inquiring into whether a represcription proceeding should be initiated at this time. We, however, are adopting 8.64% as the trigger reference point for determining when our next represcription proceeding may be warranted.

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[103] The Commission adopted the 1990 Represcription Order on September 19, 1990. The average yield for ten-year Treasury securities for the previous six-month period from March 1990 through August 1990 equals 8.64%.

B. Conduct of Represcription Proceedings

1. Overall Procedures

a. Overview

43. In order to allow us to prescribe a rate of return for interstate access services, Part 65 of our rules sets out trial-type procedures for conducting represcriptions that include notices of appearance, initial submissions, responsive submissions, rebuttals, discovery, possible cross-examination, proposed findings of fact and conclusions, reply findings and conclusions, possible oral argument, and use of a separated trial staff at the discretion of the Bureau.[104] In the Notice, we tentatively concluded that this system goes far beyond what is necessary to achieve the goals of our represcription proceedings, and we proposed to replace it with a simpler notice and comment system.[105] Under the proposed system, we would initiate a represcription proceeding through a notice that would include a procedural schedule.[106] We stated our intention that, if we decided in this rulemaking to require participants to file evidentiary information at the start of the proceeding,[107] the notice would set a deadline for submitting it.[108] We tentatively concluded that the subsequent pleading schedule should include comments and replies, and we invited commenters to tell us whether rebuttals would also be necessary.[109] We also tentatively concluded that notices of appearance, proposed findings and conclusions, reply findings and conclusions, and a separated trial staff would be unnecessary.[110] To help focus the proceedings, we proposed to reduce the length of pleadings from 70 to 50 pages for initial comments, from 50 to 35 pages for replies, and (if applicable) from 35 to 25 pages for rebuttals.[111] We sought comment on all these issues.

44. We also proposed to eliminate rules providing for possible oral cross-examination of witnesses[112] and oral argument.[113] To obtain cross-examination under the current rules, a

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[104] We refer to these procedures collectively as a "paper hearing."

[105] Notice, 7 FCC Rcd at 4692, para. 27.

[106] Id. at para. 28.

[107] See infra Section IV.B.3.c.

[108] Notice, 7 FCC Rcd at 4692, para. 29.

[109] Id. at para. 30.

[110] Id.

[111] Id.

[112] 47 C.F.R. §65.104.

party must show that use of written procedures would be prejudicial; that cross-examination is necessary to achieve a full and fair record; that written procedures are inadequate to resolve genuine, substantial, material questions of fact decisively; and that only cross-examination can decisively resolve those questions.[114] To obtain oral argument under those rules, a party must show that oral argument is necessary for a full and fair record; that written argument would be prejudicial; that due and full consideration of all matters of fact and law require oral argument; and that written procedures would not produce the benefits expected from oral argument.[115]

45. In the Notice, we explained that our authority to order cross-examination and oral argument stems from Section 4(j) of the Communications Act[116] and that, among our rules, Part 65 is unique in its attempts to particularize the Commission's statutory mandate to "conduct its proceedings in such manner as will best conduce to the proper dispatch of business and to the ends of justice"[117] by describing circumstances in rulemakings that would warrant use of cross-examination and oral argument. We stated that this particularized treatment implies that rate of return represcription rulemakings are somehow different from other rulemakings.[118] We criticized this implication as incorrect and found that no useful purpose would be served by retaining special rules for cross-examination and oral argument in Part 65.[119] We proposed to eliminate these special rules, but stated that we would retain overall authority to order cross-examination and oral argument in appropriate circumstances. We invited comment on these proposals.[120]

b. Comments

46. There is widespread agreement among the commenters that we can and should simplify our Part 65 represcription procedures, but sharp disagreement over whether notice and comment procedures are an adequate or desirable substitute for paper hearings. Most commenters who address this issue state that the existing procedures are cumbersome and that represcription proceedings, as a result, can be unnecessarily burdensome and costly for

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[113] Id. §65.106.

[114] Id. §65.104.

[115] Id. §65.106.

[116] Id. §154(j).

[117] Id.

[118] Notice, 7 FCC Rcd at 4693, at para. 39.

[119] Id.

[120] Id.

participants.[121]

47. Non-LEC commenters generally embrace notice and comment procedures so long as these procedures provide for discovery.[122] Thus, MCI says that properly structured notice and comment procedures, i.e., those that include full disclosure of relevant information by parties, are an adequate substitute for the current paper hearing regime.[123] MCI states that such procedures would eliminate the need for notices of appearance, proposed findings and conclusions, and a separated trial staff.[124] MCI, however, opposes our suggested reduced page limitations, unless we exempt attachments from the page limits. If attachments are included, MCI proposes 35 or 50 pages for comments, 50 pages for replies, and 35 pages for rebuttals.[125] MCI also argues that we should afford parties ample time within which to analyze the record. MCI suggests that initial comments be due six weeks after the Commission issues a notice commencing the proceeding, with replies due six weeks after the filing of initial comments. Moreover, MCI would have us extend rebuttal rights to all parties because, according to MCI, it is unlikely that only two rounds of pleadings will present all relevant information and parties "must be able to rebut each other's reply comments."[126]

48. GSA agrees that we should replace existing Part 65 paper hearing rules with notice and comment procedures, but says that we must not limit the evidence presented during prescription proceedings.[127] SBA also supports notice and comment procedures because such procedures assertedly would reduce the regulatory costs borne by small LECs.[128] SBA states that initial filings and replies would provide sufficient opportunity for all parties to be heard,[129] but argues that page limitations should not be imposed in

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[121] See FWA Comments at 2; SBA Comments at 9; MCI Comments at 9. See also USTA Comments at 18 (existing Part 65 rules go beyond what is necessary to achieve fair and lawful prescription under the Act, but Notice goes too far in proposing to substitute notice and comment for paper hearing).

[122] See, e.g., FWA Comments at 2-3; GSA Comments at 11; SBA Comments at 9-11.

[123] MCI Comments at 9.

[124] Id. at 9, 22 (Commission must develop substitute for notice of appearance requirement in order to ensure prompt service on all parties).

[125] MCI Comments at 15-16 (lower page limits for initial comments forces LECs to "focus" arguments).

[126] Id. at 14 (complexity of cost of equity issues will require parties in rebuttal comments to develop new responses to other parties' replies). The current rules only contemplate carrier rebuttals. See 47 C.F.R. §65.102(b)(3).

[127] GSA Comments at 11.

[128] SBA Comments at 9.

[129] Id.

rulemakings, including represcription proceedings.[130]

49. While non-LEC commenters generally support notice and comment procedures. LEC commenters and their representatives claim that paper hearings that offer opportunities for reasonable discovery represent the minimum procedure that comports with due process. and are otherwise necessary in order for the Commission and affected LECs to compile a complete record for decision-making.[131] According to Rochester and USTA, Section 205(a) of the Communications Act,[132] the Administrative Procedure Act ("APA"), and relevant case law mandate paper hearings,[133] and require more than notice and comment if represcription proceedings are to provide a "full opportunity to be heard."[134] Moreover, Rochester and USTA argue that, in cases where the Commission proposes to decrease the prescribed rate of return, the Commission assumes the burden of proof. Rochester and USTA contend that adopting an automatic trigger and conducting a subsequent proceeding according to notice and comment procedures would unlawfully shift the burden of proof away from the proponent (i.e., the Commission) to the LECs.[135] Even if the Commission were to conclude that notice and comment procedures satisfy legal requirements for ratemaking procedures, Rochester and USTA maintain that the Commission still should conclude that such procedures are ill-suited for highly fact-specific, adversarial-type inquiries like represcription proceedings.[136]

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[130] Id. at 9-10.

[131] Rochester Comments at 5-8; USTA Comments at 7-8. See also, e.g., Alltel Comments at 2; BellSouth Comments at 1; Lexington Comments at 1-2; SNET Comments at 1-2; United Comments at 9-10. But see Centel Comments at 7 (urging notice and comment proceedings providing, inter alia, for initial comments. replies and rebuttals and urging strict limits on discovery, cross-examination, and oral argument if the Commission retains paper hearings).

[132] 47 U.S.C. §205.

[133] Rochester Comments at 8-10, citing Mobil Oil Corporation v. FPC, 483 F.2d 1238, 1262-63 (D.C. Cir 1973); USTA Comments at 11-16. Rochester maintains that although the APA defines ratemaking as rulemaking, ratemaking represents a special exception to the general APA rule that notice and comment proceedings are appropriate for rulemakings. Rochester Comments at 8-9.

[134] Rochester Comments at 5-8; USTA Comments at 7-8. See also United Comments at 10 (supports USTA's legal analysis).

[135] Rochester Comments at 10-11; USTA Comments at 9-10 (Bureau as proponent becomes a party to the represcription proceeding and other parties have discovery rights in order to evaluate data and information upon which Bureau bases its position); See also BellSouth Comments at 1-2 (Commission proposals to expand role of Bureau information requests and eliminate separated trial staff are inconsistent; active role of Bureau, as party, necessitates creation of separated trial staff to manage non-party discovery); United Comments at 10.

[136] Rochester Comments at 11-12 (individuals under oath likelier to be accurate; adversarial proceedings more appropriate for highly fact-based inquiries); USTA Comments at 12 (importance of cost of capital issues to LECs necessitates discovery and opportunity to examine experts on contested factual issues; notice and comment

50. Nevertheless, Rochester and USTA agree that the existing paper hearing procedures can be simplified. They urge us to retain paper hearings while streamlining the procedures and removing unnecessary rule sections.[137] Rochester and USTA say that the Commission should allow parties to file direct cases, rebuttal cases and responsive cases within appropriate page limits and timeframes.[138] Rochester asserts that the direct cases should contain all the supporting materials and proposed findings that the proponent thinks support its rate of return recommendation.[139] Rochester proposes that other participants, including non-carriers, be able to participate by filing responsive cases that would be served on all parties filing direct cases.[140] Under this system, parties thereafter would file rebuttal cases within a time frame similar to that established for responsive cases.[141] Rochester notes that its proposed procedures, including its proposals for discovery,[142] should eliminate the need for a separated trial staff, mandatory proposed findings and conclusions, cross-examination, and oral argument.[143] USTA agrees, and argues that considerations of fairness and sound decision making argue for retaining opportunities for a separated trial staff, cross-examination and oral argument, even if we eliminate such specific provisions from Part 65.[144]

c. Discussion

51. Based on our review of the record, we conclude that the public interest would be better served by streamlining our existing paper hearing procedures, than by adopting the simpler notice and comment regime that we proposed in the Notice. We based our proposal

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procedures invite conclusory pleadings, rather than rigorous and well-supported argument).

[137] Rochester Comments at 7-21 (streamlined procedures with curtailed discovery allow elimination of separated trial staff, proposed findings, reply findings, cross-examination and oral argument); USTA Comments at 18-31 (argues for streamlined discovery procedures, while retaining opportunities for additional discovery, cross-examination and oral argument).

[138] Rochester Comments at 17-18 (supporting page limits for direct cases and responsive cases as proposed in Notice for comments and reply comments; supporting associated timeframes proposed in Notice, plus rebuttals within timeframe similar to that proposed for reply comments); USTA Comments at 19-20 (central feature of paper hearing -- direct case, responsive case, and rebuttal -- should be retained; page limitations can be reduced more than proposed in Notice).

[139] Rochester Comments at 17-18.

[140] Id. at 18.

[141] Rochester Comments at 19; USTA Comments at 26.

[142] See infra Section IV.B.

[143] Rochester Comments at 21 (separated trial staff must be retained if Commission acts as party as well as decision maker; cross examination and oral argument available on discretionary basis).

[144] USTA Comments at 16.